

**TRG PAKISTAN LIMITED (TRG)****Ratings (April 2007)**

TRG Pakistan Limited

Entity

Long Term	BBB+
Short Term	A2

Financial Data

PKR (mln)	30-Jun-06	30-Jun-05
Total Assets	4,628.1	4,433.5
Equity	1,596.9	2,092.8
Turnover	8,823.8	5,978.9
Net Income	(634.6)	(185.7)
Gross Margin (%)	26.53	30.28
ROE (%)	(79.48)	(17.75)
EBIDTA	(18.4)	97.1
Net Debt / Equity (%)	Surplus	93.35

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Assessment

- The ratings reflect TRG's leading position in the business process outsourcing (BPO) segment, emanating from superior technology platform, quality of human resource and systems and processes, and its fast expanding size through acquisitions. At the same time, the ratings take into account the company's relatively prolonged loss making gestation phase. The management is hopeful of engendering a turnaround on account of continuing cost rationalization, improving operational efficiency and progressive migration of labour to improve margins. However, the extent of achieving financial turnaround and the related timeline remains to be seen.
- The company's primary business risk emanates from the threat of losing clientele in the process of migration. If a well-reputed, known client shifts its business, it could trigger off a domino effect resulting in significant loss of business. To mitigate this risk, the company, while ensuring high quality of service, is strengthening its sales and marketing operations. Although this increases marketing expense, it would be beneficial for the company in the long run. This coupled with the company's focus on developing a group wide brand image has started to show results in the form of inclusion of some prestigious world-renowned customers. While TRG did not experience any significant client departure in the recent quarter, the cost of efforts to retain these clients and the time lag in replacing outgoing business were important factors that account for recent losses.
- The company has a three-phase business strategy, which includes (a) acquisition of businesses having good prospects but are in their gestation phase (b) offshore migration of these businesses, and (c) concentration on organic sales. The company's wholly owned subsidiary TRG international, incorporated in Bermuda, has been active in acquiring call centres of small to medium size. Although these call centres have low migration potential, attractive entry valuation has prompted their acquisitions. While continuing acquisitions of these companies have contributed heavily towards revenue growth, simultaneous increase in operating costs led to prolonged loss making phase. The company now plans to consolidate this segment and focus on organic growth of these call centres. Following the same strategy, TRG is now planning to shift its focus on already profitable non-voice BPOs, primarily healthcare. This would enable the company to concentrate on a segment with higher migration potential. Although entry valuation for such businesses is higher, tight customer contracts, unlike call center clientele, provide a definite advantage. Going forward, while the company would require greater funding arrangements for such acquisitions, these new businesses are expected to contribute towards the bottom line immediately after acquisition. In line with such initiatives, the company, while spreading incidence of fixed cost, is expected to attain breakeven shortly and adequate net profit in FY08. However, ROE, though initially would remain low, is expected to touch double figures in the medium-term.
- TRG borrowed significant amount of funds in FY06 primarily to bridge finance its spree of acquisitions. The major portion of debt was settled in August 06 through a right issue of 60% at par. This translated into surplus net debt to equity ratio alongwith strengthening of coverages. Going forward, the company plans to finance most of its acquisitions through equity injection. The company may also face constraints in terms of local borrowings due to insufficient tangible assets and strained cash flows from operations.

Key Rating Drivers

- These ratings are dependent on effective execution of the company's strategy to improve profitability. Nevertheless, any significant delay in financial turnaround timeline or significant debt acquisition for future investments without supporting cash flows would have negative implications for ratings. Any unexpected and significant withdrawal of clientele from the acquiree companies could also have adverse impact on ratings as it could have a negative impact on the company's business prospects. Meanwhile, material, sustainable improvement in the financial profile of the company would have positive implications for the ratings.

Profile

- TRG, incorporated in Dec 2002 and listed on Karachi stock exchange, started operations in April 2003. It is the country's largest venture capital company of its kind. As at February 5, 2007, TRG major shareholders include JS Group, some members of the board, International Finance Corporation and the Packages Group. Otherwise the shareholding of TRG is not closely held by any one group.
- The principal activity of the company is to directly or indirectly acquire, manage and maintain the business of telephone answering services, call centers and provide other business processing services. The management team, headed by Mr. Zia Chishti in the US and Mr. Ali Jameel in Pakistan, is a blend of some highly qualified personnel with entrepreneurial flair and considerable international experience.